Cite policy requirement, or explain why item is on the Board agenda: The purpose of this Board report is to present to the Finance committee of the Board of Trustees the audited financial report for the Minnesota State Colleges and Universities for the year ending June 30th 2008 and 2007 and the results of individual institutions financial statement audits.

Scheduled Presenter(s): Laura M. King, Vice Chancellor - Chief Financial Officer  
Tim Stoddard, Assistant Vice Chancellor Financial Reporting

Outline of Key Points/Policy Issues: The system wide audit, revenue fund audit and the twelve individual college and university audits received unqualified opinion letters from the respective audit firms. The opinion letters provide the Board and other users of the financial statements with assurance that the information is accurate and reliable in all material respects.

FY 2008 operating results yielded a modest improvement in financial position at June 30, 2008. Net assets increased $120 million or 9.1 percent; most of the increase was due to FY 2008 capital appropriation revenue of $102 million that funded capital asset investment, preservation and replacement. Income before other revenues, expenses, gains or losses, also termed “operating margin” further below, increased from $7 million in FY 2007 to $8 million in FY 2008. This positive operating margin is the net of $1,684 million of operating and nonoperating revenues less $1,676 million of operating and nonoperating expenses.

The Statements of Net Assets, often referred to as the balance sheet, mirrors the year’s financial results with modest growth in assets and liabilities. The Primary Reserve measure remained constant at 2.5 months of operating expenses.

Background Information: The financial statements were prepared by the Finance division of the Office of the Chancellor with the assistance of the campus Finance departments and have been audited by the firm of Kern, DeWenter, Viere, Ltd.
BACKGROUND

The purpose of this Board report is to present to the Finance, Facilities and Technology committee of the Board of Trustees the audited, consolidated financial statements for the Minnesota State Colleges and Universities for the years ending June 30, 2008 and 2007. These financial statements were prepared by the Finance division of the Office of the Chancellor with the assistance of the campus Finance departments and have been audited by the firm of Kern, DeWenter, Viere, Ltd. This is the second year of a second consecutive three year contract with Kern, DeWenter, Viere, Ltd. as the system auditor. These statements were presented to the Audit Committee by the Finance division and Kern, DeWenter, Viere, Ltd., at the November 18, 2008 Audit Committee meeting.

AUDIT RESULTS

The system wide audit, revenue fund audit and the twelve individual college and university audits received unqualified opinion letters from the respective audit firms. The opinion letters provide the Board and other users of the financial statements with assurance that the information is accurate and reliable in all material respects.

The three external audit firms presented their respective results of audits, including audit opinions, internal control matters and other required communications at the November 18 Audit Committee meeting. In addition, the three audit firms communicated results of internal control assessments in writing to the Board of Trustees.

Kern, DeWenter, Viere, Ltd, again issued a separate management letter for the system wide statements. This letter contained comments on matters deemed less significant under audit standards including internal controls, accounting, administration and operating matters. Management agrees with and will take the necessary steps to respond to the observations made in the management letter.

The Revenue Fund and twelve individual college and university financial statements have been incorporated into the consolidated system wide financial statements along with the financial statements of the unaudited colleges. The Audit Committee members spent considerable individual time reviewing the various annual financial reports prior to the formal meeting. The two hour formal Audit Committee meeting generated good discussion based on Trustees’ questions. The Audit Committee recommended release of the audited statements, a motion that was approved by the full Board of Trustees at the November 19, 2008 meeting.
All audited financial reports may be viewed on the system’s website at: http://www.finance.mnscu.edu/accounting/financialstatements/index.html

INFORMATION

The system wide financial report for fiscal years 2008 and 2007 is presented in accordance with Statement No. 35 Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities as established by the Governmental Accounting Standards Board (GASB). The system’s financial information is presented in one column form as a “Business Type Activity”. The resources are still governed by the governmental fund based principles and continue to be accounted for in the general, special revenue, enterprise, and revenue funds. Fund level information can be found in the financial statement supplemental schedules contained in a separate report (unaudited) titled “Supplement to the Annual Financial Report for the year ended June 30, 2008.” This supplemental report also contains financial statements for each college and university.

All university foundations plus the Century College Foundation and Fergus Area College Foundation are separately included in the related institutions’ financial reports and the system’s financial report. Reporting standards require the inclusion of component entities if found to be “significant” to the primary organization. The foundations and their auditors are very cooperative in adjusting their audit schedules in order to conform to the system’s financial reporting audit schedule.

Summary of Financial Results

Fiscal year 2008 operating results yielded a modest improvement in financial position at June 30, 2008. Net assets increased $120 million or 9.1 percent; most of the increase was due to fiscal year 2008 capital appropriation revenue of $102 million that funded capital asset investment, preservation and replacement. Income before other revenues, expenses, gains or losses, also termed “operating margin” further below, increased from $7 million in fiscal year 2007 to $8 million in fiscal year 2008. This positive operating margin is the net of $1,684 million of operating and nonoperating revenues less $1,676 million of operating and nonoperating expenses.

The Statements of Net Assets, often referred to as the balance sheet, mirrors the year’s financial results with modest growth in assets and liabilities. The Primary Reserve measure discussed further below remained constant at 2.5 months of operating expenses.

Consolidated Statements of Net Assets

The primary driver of change within the Statements of Net Assets between June 30, 2008 and 2007 is capital asset development and renewal activity related to the system’s 26 million square feet of academic and administrative buildings.

• New construction in progress of $201.8 million increased the capital assets balance, net of depreciation, by $154.3 million
• Capital asset financing came primarily from $102 million of capital appropriation and $84.7 million of new long-term debt
• Net assets (e.g., net worth) increased $119.9 million including a $90.7 million increase in net assets invested in capital assets, net of related debt

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

Fiscal year 2008 operating expenses of $1,676 million average $4.6 million per day when divided by 365 days. The positive net operating margin of $8.4 million represented a surplus equivalent to less than two days of operating expense.

• Revenue sources funding operations included $748 million of state appropriation and grants, $695 million of student payments, net, $189 million of federal grants, and $53 million of other revenue
• Expenses supporting operations included $1,160 million of compensation, $221 million of purchased services (utilities, enterprise and other IT support, etc.), $87 million of supplies, $77 million of depreciation and other expenses of $131 million

Summary ratios for FY2008, FY2007 and FY2006

The system-wide ratios and measures presented below are consistent with prior years’ presentations, include ratios used by the Higher Learning Commission to measure financial health and are common measures used by rating services such as Moody’s Investor Service (Moody’s). All ratios are computed using financial data taken from the accrual financial statements. Note: Higher values are deemed better for all ratios presented.

Summary college and university results, including financial condition and ratio information, are presented further below. The Supplement to the Annual Financial Report may be examined to learn more about individual college and university financial performance (http://www.finance.mnscu.edu/accounting/financialstatements/yearendstatements/index.html).

The system’s ratios along with fiscal years 2007 and 2006 performance measures published by Moody’s--national median values for over 200 public colleges and universities nationwide--are shown below.

Moody’s national data population includes a wide range of public institutions, including Research I institutions, but does not include two-year colleges (except for those included in a system) and so is not strictly comparable in all respects to the Minnesota State Colleges & Universities system. Moody’s median data is provided here for general comparative purposes. Appendix A includes additional, secondary ratios.
The number of months of primary reserve measures the system’s capacity to fund operating expenses without generating new assets. That is, the number of months of annual operating expenses that could be financed using reserves. This is an accrual measure somewhat similar in concept to the Board’s “budget reserve” ratio. An increasing primary reserve measure indicates that expendable (restricted and unrestricted) net assets have increased from one year to the next at a greater pace than operating expense growth.

The net income ratio measures whether an organization is operating with a surplus or deficit by comparing the change in total net assets (i.e., net income) to total revenues. Moody’s does not compute net income ratio median values. This ratio is heavily influenced by the system’s pattern of GO bond financed HEAPR and construction activity and the related level of capital appropriation revenue. Capital appropriation revenue is a long-term, strategic source of revenue; however, it is not available to fund operating expenses.
The annual operating margin above is somewhat similar to the net income ratio, but it excludes revenue generally not available to cover operating expenses. This is computed at the “Income Before Other Revenues, Expenses, Gains, or Losses” line on the Consolidated Statements of Revenues, Expenses, and Changes in Net Assets. The near breakeven 0.5 percent margin in fiscal year 2008 represents $8.4 million of positive operating margin divided by $1.68 billion of revenue; in other words, $0.995 of every dollar of revenue supported operating costs. To equal the 2007 Mood’s national median of 2.0%, the system would have required an operating margin of $33.7 million.

The viability ratio is a debt capacity indicator and also shows how well expendable net assets cover existing debt should events cause a decrease in non-cash asset values. This ratio has declined in fiscal years 2008 and 2007 as the rate of growth in debt exceeded the rate of growth in expendable net assets; additional Revenue Bond sales of $41 million and $43.1 million in fiscal years 2008 and 2007, respectively, contributed to this trend. The system is responsible for all Revenue Bond debt service costs.
The system-wide Board required reserve ratio compares general fund cash-basis operating revenues to that portion of the general fund’s end-of-year cash balance that has been designated as a special reserve amount. The primary reserve measure discussed further above is somewhat similar in concept but is an all funds accrual-based measure computing the number of months of operating expenses covered by expendable net assets.

**Selected ratios of institutional performance**

In the table below, all colleges and universities were divided into three groups based on relative performance against each measure presented and an average computed for each group. Colleges and universities may fall in different tiers depending upon the measure.

<table>
<thead>
<tr>
<th>Tier</th>
<th>Primary Reserve--# months</th>
<th>Net Income Ratio</th>
<th>Viability Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower 1/3</td>
<td>0.9</td>
<td>0.9</td>
<td>0.8</td>
</tr>
<tr>
<td>Middle 1/3</td>
<td>2.0</td>
<td>2.0</td>
<td>1.9</td>
</tr>
<tr>
<td>Upper 1/3</td>
<td>3.0</td>
<td>3.2</td>
<td>3.0</td>
</tr>
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</table>

The three measures above reflect a broad range of financial conditions. Fiscal year 2008 saw a slight decline in the primary reserve measure at a number of colleges and universities and declines in net income ratios. The strong capital bonding activity coupled with a revenue bond issue in fiscal year 2008 resulted in additional long-term debt and a decrease in the viability ratios at many colleges and universities.
As shown above, 19 of the system’s 32 colleges and universities continue to generate negative results from operations using a generally accepted accounting principles measurement; this compares to 18 colleges and universities in fiscal year 2007. Of the 19 colleges and universities with a negative fiscal year 2008 operating margin, 14 had a negative operating margin in all three fiscal years shown above. Ongoing operating deficits negatively impact the ability of these institutions to maintain normal operations under adverse economic circumstances, such as the current recession, or implement new strategic initiatives. Negative unrestricted net assets generally indicate a college or university has experienced ongoing operating deficits. A Board reserve at less than 3 percent can also be an indicator of poor financial condition.

**CONCLUSION**

The system’s financial condition remained constant during FY2008 reflecting the strong financial management exercised by the system’s leadership team. The current recession raises significant concerns regarding the ability of state government to provide adequate funding in the form of appropriation and grant revenue. The fiscal year 2009 state appropriation exceeds fiscal year 2008 by $17 million; however, the projected state fiscal year 2009 deficit has also resulted in a $20 million downward appropriation adjustment. Looking beyond 2009, recent state financial projections show a nearly $5 billion budget deficit for the fiscal years 2010 and 2011 biennium. Continued increases in long-term debt, both general obligation and revenue bond debt, are reflected in a declining viability ratio, and this may continue in future years subject to increases in capital bonding support and Revenue Bond sales. Increases in debt service may place an additional financial burden on some institutions in future years if coupled with declining revenue. The Chancellor and the presidents are dedicated to and will make every effort to continue the Board’s commitment to access, quality, affordability and innovation for the benefit of current and future students and the state as a whole.

*As shown in financial statements on line titled “Income (loss) before other revenues, expenses, gains, or losses.” The Northeast Higher Education District is considered one college.*
APPENDIX A

Secondary Ratios

<table>
<thead>
<tr>
<th></th>
<th>FY2008</th>
<th>FY2007</th>
<th>FY2006</th>
</tr>
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<tbody>
<tr>
<td><strong>System scholarship allowance</strong></td>
<td>29%</td>
<td>28%</td>
<td>27%</td>
</tr>
<tr>
<td><strong>National median</strong></td>
<td>28%</td>
<td>28%</td>
<td></td>
</tr>
</tbody>
</table>

The above ratio measures the amount of tuition and fees financed by financial aid grant programs. The ratio also captures private grant programs and scholarship discounts, which are minimal for the system. The increase in this ratio’s 2008 value is in part due to an increased number of students plus increased grant support, especially federal grant support.

<table>
<thead>
<tr>
<th></th>
<th>FY2008</th>
<th>FY2007</th>
<th>FY2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>System equity ratio</strong></td>
<td>64%</td>
<td>63%</td>
<td>65%</td>
</tr>
<tr>
<td><strong>National median</strong></td>
<td></td>
<td></td>
<td>not computed</td>
</tr>
</tbody>
</table>

The above ratio measures the system’s ownership interest or equity position in system assets. This ratio is positively influenced by the state’s two-thirds contribution to the GO bond debt issued for the system’s acquisition of capital assets and negatively influenced by the amount of accumulated depreciation present in our physical plant and other factors such as the fiscal years 2008 and 2007 issuance of revenue bonds of $41 and $43.1 million, respectively.

<table>
<thead>
<tr>
<th></th>
<th>FY2008</th>
<th>FY2007</th>
<th>FY2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>System salaries and benefits as % of total expenses</strong></td>
<td>69%</td>
<td>69%</td>
<td>70%</td>
</tr>
<tr>
<td><strong>National Median</strong></td>
<td></td>
<td></td>
<td>not computed</td>
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</tbody>
</table>

The above ratio measures utilization of the system’s resources to pay personnel costs. The remaining approximate 30 percent represents spending in other parts of the operation such as utilities, depreciation, facility maintenance and technology. Salaries and benefits increased $88 million (8.2 percent) while all other expenses increased by a net of $36 million with much of the increase due to higher expenditures for information technology and energy costs.

<table>
<thead>
<tr>
<th></th>
<th>FY2008</th>
<th>FY2007</th>
<th>FY2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>System net tuition and fee revenue as % of total revenue</strong></td>
<td>31.0%</td>
<td>31.2%</td>
<td>31.3%</td>
</tr>
<tr>
<td><strong>National median</strong></td>
<td></td>
<td></td>
<td>26.0%</td>
</tr>
</tbody>
</table>

This ratio measures the system’s reliance on tuition and fee revenue from students. Fiscal year 2008 gross tuition and fee revenue increased $50 million, a 7.3 percent increase over fiscal year 2007. Total scholarship allowance plus financial aid paid directly to students increased by $17 million, an 8.4 percent increase over fiscal year 2007. The higher growth in scholarship allowance plus direct financial aid was one reason for the slight decline in the above ratio for fiscal year 2008.